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¶1. (SBU) SUMMARY AND COMMENT: Estonia's economic ties with Russia are modest and relatively straightforward. Bilateral trade with Russia has held steady for several years at around eight percent of Estonia's total, with imports dominated by mineral fuels. Exports are spread across all sectors. Inward direct investment from Russia is about two percent of Estonia's total, concentrated in transit and real estate. Russian businessmen characterize the relationship as basically good, as long as politics can "stay out of it." Observers from across the Government of Estonia (GOE) concur that Estonia is "saved by its small size" whereby it is easy to track investors and investments (making it hard for Russia to infiltrate the economy). The Ministry of Defense (MOD) keeps a close eye on the facets of the economic relationship that might impact on energy or cyber security, another factor limiting Estonia's vulnerability. Estonia will remain dependent on Russia for much of its oil and gas over the next decade - and will no doubt hit periodic bumps in the road on transit and trade issues - but Russian economic ties are less consequential than are Estonia's ties with other Baltic Sea neighbors, and the wider European Union. END SUMMARY AND COMMENT.

¶2. (U) Estonia has close but limited economic ties with Russia, built on a long history of complex relations with its eastern neighbor. Since Estonia re-gained independence in 1991, Russia's importance to the economy has steadily receded in favor of stronger trade, investment and business ties with Scandinavia, Latvia and Lithuania. Russia's influence in the Estonian economy is evident primarily in the transit sector. This was seen acutely in the summer and fall of 2007, when inbound coal shipments plummeted by almost 90 percent, and petroleum by 50 percent, following the April 2007 riots following the GOE's decision to relocate a Soviet-era statue from central Tallinn (the 'Bronze Soldier'). Even then, Russia's decision to re-direct this cargo from Estonian to Russian ports is seen by GOE officials less as the result of those events, than as a strategic decision by Moscow to use the Primorsk and Ust-Luga ports inside Russia instead of Estonian ports, as expansion projects and warmer winters increase annual capacity at those competitors. While these losses now appear to be permanent, the estimated impact of lost transit revenues on Estonian GDP is less than one percent.

Bilateral Trade and Investment: Steady but Modest

¶3. (U) Estonia's 2007 GDP (roughly USD 15 billion) is

on par with the annual revenues of U.S. Steel, near the bottom of the Fortune Global 500, or equal to half the state domestic product of North Dakota. In 2007, net bilateral trade between Estonia and Russia accounted for 4 percent of Estonian GDP, down from 7.4 percent in 2006. While exports from Estonia to Russia are diverse, (foodstuffs, chemicals, machinery, and vehicles each comprise 10-20 percent), imports are skewed 60-70 percent toward fossil fuels and minerals.

¶4. (U) Foreign direct investment (FDI) between Russia and Estonia appears even less significant to both economies than trade. Russia's share of total FDI in Estonia has hovered around 2 percent since 2004, roughly equivalent to the U.S. share of FDI during that same time. Russian investment is concentrated mostly in smaller, privately owned ports such as Sillamae and North Paldiski (both former Soviet military sites), the transit sector, and small amounts in real estate. The leading foreign investors in Estonia are Sweden and Finland, both of which are dominant in the financial sector. Together, these two countries make up over 65 percent of FDI, with no other single country having more than 5 percent. Russia receives about 8 percent of Estonia's outbound FDI, with the clear majority (63 percent) going to Latvia and Lithuania.

Beneath the Numbers: Don't Mix Business and Politics

¶5. (SBU) The Estonian-Russian Chamber of Businessmen (ERPP) has 21 members (compared to 112 in the Estonian-American Chamber of Commerce). Victor

Novokreshchenov, a member of the ERPP's board, told us they focus primarily on promoting business relations and cooperation agreements between Estonian and Russian firms. Among ERPP's membership, there is a heavy emphasis on marine insurance and re-insurance brokers, customs agents and other transit-related companies. Yuri Netchayev, director of one such firm that is affiliated with Wells Fargo, told us that Russians are still interested in doing business with Estonia "...as much as allowed by the political situation." Companies on both sides are not turning away from one another, he noted, but officials on both sides consider it less risky to go through neighboring countries first, using trucks registered in Latvia or Finland, for example. Sometimes, officials on the Russian side of the border will advise the ERPP on how best to get shipments through based on the circumstances. Asked about influence from Moscow on economic ties between the two countries, Novokreshchenov commented that Moscow's influence is most pronounced with respect to raw materials, over which Moscow has the greatest control, and is seen as less of an impediment for private companies dealing in services or processed goods.

¶6. (U) ERPP member companies deal more or less equally with Estonian- and Russian-speaking customers, and few feel a need to learn the Estonian language to do business here. As for the Estonian government's influence on the bilateral business climate, the ERPP members with whom we spoke felt there was little chance that a government led by PM Andrus Ansip would improve the business dynamic - signaling a Russian perception that Ansip's Reform Party (at least) has an anti-Russian bias. This perception is heightened by, but not solely attributed to, Ansip's decision to move the Bronze Soldier statue. None of the members with whom we spoke were especially concerned by the periodic, seasonal crossing delays (up to 34 hours in May 2008) that trucks experience at the Russian border at Narva. These ERPP members felt that bureaucratic

slowdowns were just a fact of life in Russia - not unique to crossings at the Estonian border, and that this was proof of the success of Vladimir Putin's crackdown on corruption a few years ago was a success.

How Much Russian Influence?

¶7. (SBU) Several key Estonian interlocutors told us that the small size of the Estonian economy, and the low number of key players within it, made it hard to hide any sizeable business activity. Priit Pallum, Director General of the Estonian MFA's Department of External Economic and Development Cooperation, acknowledged that "There is some trade circumvention in every economy, and Russia is no exception." He felt confident, however, that any Russian impact on Estonia's economy (over and above the official 4 percent from trade) would be apparent. Mart Kivine, Advisor both to the Finance Minister and President Ilves, said that Estonia is "saved by its small size" and added that it is hard for him to see Russian investment posing a risk to Estonia. (Note: Estonia does not screen foreign investors, but it does require licenses for banking, mining, transport, water supply, etc. to set ownership responsibilities. End Note.) "There are those in Estonia who see an opportunity to make money doing business with Russia, and those who see risk," MFA's Pallum said, "and the two groups basically do what they each think is in their own best interest."

¶8. (SBU) One GOE institution that spends more time thinking about risk than opportunity is Estonia's Ministry of Defense (MOD). Though not directly charged with looking at the economy, the MOD has a strong interest in energy- and cyber- security, stability of financial markets, and FDI in sensitive sectors of the economy. MOD's Director of Policy Planning, Christian-Marc Liflander, told us that, in fact, the impact of the transit sector in 2007 was exaggerated (related to the Bronze Soldier riots), and that global markets are far more important to Estonia's economy. The real economic concern with respect to Russia, he said, is the fact that capital is concentrated in the hands of so few, who themselves are subject to manipulation inside Russia. In Liflander's assessment, Russia does not try to exploit foreign customers if it is getting a market price from

them, and in fact favors them over domestic buyers. The Ministry of Finance's Kivine echoed this fairly pragmatic assessment, noting that Estonia has "...no systematic dependence on Russia in any area of trade...", and that Russian investors likely would find greater returns on their capital in larger markets such as Finland or Sweden.

¶9. (SBU) While Kivine and Liflander did not see any current evidence of a major economic vulnerability towards Russia, both drew the line at strategically sensitive areas of the economy. Liflander noted that the MOD had already opposed the idea of Estonian banks off-shoring their computer servers. If that were the case and in the event of another 2007-style cyber attack, Estonians would have no access to electronic banking or ATMs if the state had to again cut internet access with the outside world. He and Kivine both cited the example of the state-owned Port of Tallinn - the country's largest - as another place the GOE would step in to restrict foreign investment, especially Russian investment. "What would happen if NATO decided to conduct a maritime re-supply exercise in Estonia, only to find that the private owners of the port suddenly declared that it was closed for 'repairs'"?, Liflander asked. Still, Estonia has

privatized as far as it feels it can do prudently. Gazprom's 37 percent ownership of Eesti Gas, the primary retail gas distributor in the country, has raised no significant concerns. While neither Kivine nor Liflander saw any significant vulnerability resulting from Estonia's economic ties to Russia, neither saw greater involvement as desirable either. Someday, if there were greater transparency and accountability in Russian markets and investors, this might change, but neither thought this likely in the foreseeable future.

¶10. (U) A NOTE ABOUT ENERGY: Estonia relies on Russian oil and gas for half of its heat production (fifteen percent of total energy consumption). Estonia does not rely on Russian energy sources for electricity as domestic oil shale deposits provide 90 percent of the demand, and domestic peat, wind and shale oil gas provide the rest.

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